ORIGINAL

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

RECEIVED
MAY 15 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Price Cap Regulation of Local Exchange Carriers	)	CC Docket No. 93-179
	)	
Rate-of-Return Sharing and Lower Formula Adjustment	)	DOCKET FILE COPY ORIGINAL

To: The Commission

REPLY OF AMERITECH TO OPPOSITIONS TO EMERGENCY MOTION FOR STAY

The **AMERITECH OPERATING COMPANIES** ("Ameritech"), by and through their undersigned counsel, and pursuant to Section 1.45(b) of the Commission's rules, 47 C.F.R. § 1.45(b) (1994), hereby reply to the Oppositions to Ameritech's Emergency Motion for Stay Pending Judicial Review ("Emergency Motion") filed May 5, 1995, by MCI Telecommunications Corporation ("MCI") and American Telephone and Telegraph Corporation ("AT&T") (collectively, the "Oppositions").

I. AMERITECH IS LIKELY TO PREVAIL ON THE MERITS BECAUSE THE "ADD-BACK" ORDER AS APPLIED BY THE COMMISSION CONSTITUTES UNLAWFUL RETROACTIVE RULEMAKING

In its Emergency Motion, Ameritech argued that it was likely to prevail on the merits of its Court of Appeals challenge to the *Add-Back Order* because the rationale articulated by the Commission for the rule was legally unsound and the Commission's application of the rule to carriers' 1994 sharing obligations (reflected in the 1995-96 tariff filings filed on May 9, 1995), constituted unlawful retroactive rulemaking. Emergency Motion at 2-3 & n.1 (citing *Cost Support Material to be Filed with 1995 Annual Access Tariffs*, DA 95-823 (released April 14, 1995) at 7 ¶¶ 15-16); *see also Add-Back Order* at 22 ¶ 49.

No. of Copies rec'd 0+4
List A B C D E

In their respective Oppositions, both MCI and AT&T dispute that Ameritech will likely prevail on the merits of its case before the Court of Appeals. Their support for this position consists largely of a simple recapitulation of the rationale advanced by the Commission in the *Add-Back Order*. *See* MCI Opposition at 4-6; *see generally* AT&T Opposition. Ameritech set forth in substantial detail the defects in the Commission's analytical foundation for applying the add-back rule in the price cap context in its earlier filings in this proceeding,[1/] as well as in the Emergency Motion. Accordingly, it need not repeat them here. However, MCI does advance one particular point in this regard which warrants further examination.

Specifically, in support of its assertion that the add-back is necessary to avoid distortions in the measurement of a carrier's productivity, MCI states that "[t]ypically, in measuring [a] corporation's 'true' economic health, analysts ignore one-time adjustments." MCI Opposition at 6. As MCI is surely aware, economic analysts will ignore such one-time adjustments only when the adjustment in question is merely an accounting adjustment and does not impact upon the company's cash flow. Such is not the case here: as Exhibit A appended hereto demonstrates, the effect of applying the add-back rule to 1994 earnings alone would be to increase the sharing obligation payable in the 1995-96 tariff year by $24 Million: from $21 Million to $45 Million. Thus, contrary to MCI's contention, a sharing adjustment for the prior year is entirely relevant to a LEC's actual current productivity because it reduces substantially the actual net income the carrier has available to invest in plant and operations.[2/]

Proceeding from its defense of the Commission's reasoning, MCI also challenges

---

1/ *See* Comments of Ameritech in CC Docket 93-179, filed August 2, 1993; Reply Comments of Ameritech in CC Docket No. 93-179, filed September 1, 1993; *Ex Parte* Presentation of Ameritech to Mr. Gregory Vogt, Chief, and Mr. David Nall, Deputy Chief, of the Tariff Division, Common Carrier Bureau, FCC, May 6, 1994.

2/ Later in its Opposition, MCI criticizes Ameritech for allegedly failing to establish that it will experience an injury that is "both certain and great . . . ." MCI Opposition at 7 (quoting *Wisconsin Gas Co. v. FERC*, 758 F.2d 669, 674 (D.C. Cir. 1985)). There can be little doubt that the $24 million in additional sharing obligations engendered by the "add-back" rule satisfies both of these criteria.

Ameritech's retroactive rulemaking claim, criticizing Ameritech for "citing no authority," and contending that "there is nothing 'retroactive,' in any legally meaningful sense, about the adjustment required by the [*Add-Back Order*]." MCI Opposition at 6. With respect to the first issue, citation was unnecessary, and with respect to the second, MCI is simply wrong.

As to MCI's lack of authority charge, the Commission itself acknowledged the controlling principles that forbade retroactive application of its rule: regrettably, the Commission's expressed intention to effect a purely prospective application the "add-back" rule fell short of the mark in its execution when the agency decided to apply the rule to 1994 earnings.

In the *Add-Back Order*, the Commission, at the instance of commenting parties, conceded that its add-back rule could, "as a legal matter, be applied only on a prospective basis." *Add-Back Order* at 49 & n.65 (citing *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988)). Purporting to adhere to the Supreme Court's decision in *Bowen*, the Commission directed that the rule be applied for the first time to the access tariffs filed by price cap carriers in 1995. *Id.* However, ignoring the <u>holding</u> of *Bowen*, the Commission applied the rule to require carriers to revisit and adjust for any sharing made in their <u>1994 rates</u> to calculate the earnings basis for the sharing required from the carriers in their 1995-96 tariff. *Id.*; *see also Cost Support Material to be Filed with 1995 Annual Access Tariffs*, DA 95-823 (released April 14, 1995) at 7 ¶¶ 15-16).

MCI contends that the only impact of the *Add-Back Order* is on future rates. MCI Opposition at 6. But clearly this is not the case. In point of fact, the Commission's rule, as applied in the 1995-96 tariff filings, increased by more than 100 percent, retroactively,

[redacted]

in question.[3] Accordingly, it flatly conflicts with the Supreme Court's teaching in *Bowen*.

In *Bowen*, a unanimous Supreme Court rejected a rule adopted by the Secretary of Health and Human Services ("HHS") in 1984 which sought to recoup sums previously paid to hospitals (between July 1, 1981 and October 1, 1982) as reimbursement for expenses incurred in connection with provision of service to Medicare beneficiaries. The hospitals in question were required by the rule to repay to HHS more than $2 million in reimbursement payments. *Bowen*, 488 U.S. at 207. Commencing its analysis from the axioms that (1) an administrative agency's rulemaking authority stems from the authority delegated to it by Congress in its enabling legislation and (2) that authority to promulgate rules with retroactive effect will not be found unless conferred by Congress in express terms, the Court overturned the HHS rule finding it to be outside of the agency's statutory authority. *Id.* at 213, 215.

In an instructive concurrence, Justice Scalia shed additional light on the "general principles of administrative law" that undergirded majority's decision, stating his conclusion that the Administrative Procedure Act ("APA") independently supported the Court's judgment. *Id.* at 216. Specifically, Justice Scalia cited the APA's definition of a rule (as distinguished from an adjudicative order) as meaning "the whole or a part of an agency statement of general or particular applicability *and future effect* . . . ." *Id.* (quoting 5 U.S.C. § 551(4) (emphasis added by Scalia, J.). He rejected the notion that the phrase "future effect" in this context could "mean merely '*taking effect* in the future,' that is, having a future effective date even though, once effective, altering the law applied in the past," *id.* at 217 (emphasis in original), and concluded that the definition obviously meant that "a rule is a statement that has legal consequences only

---

3/ As the table appended hereto as Exhibit A demonstrates, under the pre-existing rule Ameritech owed a sharing obligation for 1994 earnings of $21 million which would be paid in 1995-96 pursuant to the access tariffs filed May 9, 1995. After recalculating its earnings for 1994 by "adding-back" the sharing amount paid during that year, Ameritech now faces a sharing obligation for 1994 earnings of $45 million. Thus, application of the "add-back" rule to the past 1994 time period has resulted in an immediate increased sharing liability for Ameritech of $24 million.

for the future." *Id.* Justice Scalia described the retroactivity of the HHS's rule as objectionable because it "alter[ed] the *past* legal consequences of past actions." *Id.* at 219 (emphasis in original).

Just as the HHS's rule impermissibly sought retroactively to change the rules governing reimbursement for Medicare services, thereby wrongly obligating hospitals to repay alleged overpayments to the agency, the Commission's application of the add-back rule adopted in 1995 more than <u>doubles</u> the sharing obligation incurred in 1994 by Ameritech. The rule as applied by the Commission thus indisputably acts to "alter[ ] the *past* legal consequences of past actions," *id.*, and is therefore unlawful.

Moreover, this is not merely the sort of 'secondary retroactivity' described in Justice Scalia's example wherein the Treasury Department adopts a rule that renders formerly tax-exempt trust income taxable. In that case, Justice Scalia observed that the Treasury Department could unquestionably prescribe such a rule "for purposes of assessing <u>future</u> income tax liability. . . ." *Id.* (emphasis added).

Rather, the instant situation corresponds more closely to a hypothetical attempt by the Treasury Department <u>in early 1995</u> to eliminate the deductibility of home mortgage interest and to require taxpayers to reflect that rule in their 1994 returns (filed in April 1995) by "adding-back" home mortgage interest when calculating their 1994 tax liability: like personal income taxes, a carrier's sharing obligation is incurred in year one and paid in arrears in year two.[4] While the IRS might have authority to adopt such a rule, flowing from a specific statutory

4/ Indeed, the thrust of the Commission's add-back rationale is to treat the sharing amount as though it had been paid by a check on the last day of the previous tariff period. *See Add-Back Order* at 1-2 ¶ 2, 9 ¶ 19. Were that actually the case, clearly the Commission could not return to the carrier after full-payment had been made and require the carrier to pay additional sums based on the application of the newly-adopted rule.

mandate conferred by Congress, see 26 U.S.C. § 7805(b),[5/] no counterpart for this authority is to be found in the Commission's enabling legislation. Thus, the FCC has no authority to increase a carrier's sharing obligation for a past earnings year by adopting a rule in the year after the obligations were incurred and giving it retroactive effect.

In addition to being "retroactive" in the sense held unlawful in *Bowen*, the rule also carries an unreasonable secondary retroactive effect which would otherwise require its invalidation: the rule effectively changed retroactively the rules applicable to Ameritech's choice of productivity factor when it made its election in its past access tariff filings, thereby depriving Ameritech of the information necessary to take ameliorative action.[6/] Had it been aware at the time it made its annual tariff filings in 1993 and 1994 that its 1994 earnings figures would be inflated by the inclusion of the sharing payments it made in that year, Ameritech could have elected the 4.3 percent productivity factor instead of the 3.3 percent factor. *See* Exhibit A appended hereto. In that event, under the "add-back" rule, Ameritech would now be confronting an additional sharing obligation of approximately $8 million rather than $24 million -- a net savings of $16 million. *Id.*

5/ Section 7805(b) provides that "[t]he Secretary may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect." 26 U.S.C. § 7805(b); *see also* Treas. Reg. § 301.7805-1(b) (1994). Moreover, it should be noted, that even the Treasury Department's authority to promulgate retroactive rules is limited by actions within the Secretary's reasonable discretion. *See, e.g., Gehl Co. v. Commissioner of Internal Revenue*, 795 F.2d 1324 (7th Cir. 1986) (§ 7805(b) establishes a presumption that Treasury regulations will be applied retroactively; however, Secretary abused discretion in giving rule retroactive effect where Treasury publication stated that future changes in the rules relative to a specific subject area would be prospective only.).

6/ *See Bowen*, 488 U.S. at 220 (Scalia, J., concurring) ("A rule that has unreasonable secondary retroactivity . . . may for that reason be 'arbitrary' or 'capricious,' see 5 U.S.C. § 706, and thus invalid.").

II. AMERITECH WILL EXPERIENCE IRREPARABLE INJURY AS A RESULT OF THE UNLAWFUL APPLICATION OF THE ADD-BACK ORDER

In its Emergency Motion, Ameritech observed that, as applied, the Commission's "add-back" rule (1) results in a dramatic mischaracterization of carrier earnings that impacts immediately and directly upon the carrier's forthcoming price cap indices, and (2) unjustifiably and unlawfully increases the amount of lawfully obtained earnings that a carrier is required to "return" to ratepayers through sharing. Emergency Motion at 3-4. MCI contests this claim, suggesting that Ameritech has failed to establish that the injury it faces is "both certain and great" and imminent. MCI Opposition at 7. In particular, MCI states that Ameritech "has not demonstrated that the exclusion of the effects of sharing on its 1994 earnings will affect the sharing obligations to be reflected in its 1995 rates."

The figures set forth in Exhibit A hereto, and discussed in the foregoing section, demonstrate in concrete fashion the immediate and dramatic impact that implementation of the "add-back" rule will have on Ameritech. If the Commission permits the 1995 access tariff to go into effect on August 1, with the required "add-back" incorporated therein, Ameritech will experience an immediate cost of $24 million in increased sharing obligations. This fact dispels any doubt that Ameritech's injury is speculative or theoretical and demonstrates that it is, in fact, imminent and palpable.

The injury thus described is also likely to be irreparable. MCI suggests that Section 65.600(d)(2) of the Commission's Rules would permit Ameritech to correct its 1994 earnings and recover sharing payments in its 1996 tariff in the event it prevails before the Court of Appeals; however, nothing in that section or in the Commission's *Order on Reconsideration* in CC Docket No. 87-313 suggests that these corrections reports were intended to permit a carrier to recover sums erroneously paid to ratepayers under sharing.[7] The reports cited by MCI will do little more than afford Ameritech the opportunity to recalibrate to an appropriate level indexes which will have been erroneously set too low to begin with as a consequence of the add-back: they would not permit Ameritech to increase the indexes by an additional margin to recapture the revenues lost during the period of the erroneous tariff. In addition, even assuming, *arguendo*, that Ameritech would be permitted to do so, such an increase in rates after the period of rates artificially and unlawfully depressed by operation of "add-back" would create a "roller-coaster" rate situation that disserves Ameritech's customers by impairing their ability to plan and rely on rates.

Moreover, the practice suggested by MCI also raises serious questions relative to the longstanding rule against retroactive ratemaking.[8] Unless the Commission is prepared to state unequivocally that this doctrine will not operate as a bar to recoupment of the revenues foregone due to the inflated sharing obligations created by the "add-back" rule, it appears almost certain that Ameritech will be unable to recover them in the event the Court of Appeals ultimately overturns the rule.

III. A STAY WOULD NOT INJURE OTHER PARTIES AND WOULD SERVE THE PUBLIC INTEREST

Finally, MCI contends that grant of a stay would be contrary to the public interest because it would result in ratepayers incurring higher access rates. MCI tacitly acknowledges

---

7/ The argument is particularly disingenuous coming as it does from MCI. As the *Order on Reconsideration* reflects, the Commission adopted the cited modification to § 65.600(d)(2) at MCI's suggestion that action was needed to close alleged loopholes in treatment of earnings that LEC's "could exploit through treatment of accrued expenses that are later reversed, and through making other accounting corrections after the three-month reporting deadline." 6 FCC Rcd at 2689 ¶ 114. Thus, it appears these reports were designed to insure that carriers accurately reported -- and captured for sharing purposes -- increased earnings in the event certain claimed costs charged against earnings were ultimately disallowed.

8/ *See, e.g., Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 578 (1981) (FERC "has no power to alter a rate retroactively"); *FPC v. Hope Natural Gas Company*, 320 U.S. 591, 618 (1944) (FPC has "no power" to fix past rates); *see also Columbia Gas Transmission Corp. v. FERC*, 831 F.2d 1137 (D.C. Cir. 1987), *reh'g den.*, 844 F.2d 879 (1988).

that, unlike amounts improperly paid out by Ameritech in increased sharing, ratepayers could recover these excessive by remedial adjustments in Ameritech's tariff in the event the Court of Appeals denies Ameritech's Petition for Review. MCI Opposition at 9. MCI tries to buttress its argument by suggesting that "the damage would have been done" by the higher rates "filtering through the economy and stunted demand." *Id.* However, MCI provides absolutely no substantiation to quantify the consequences of this speculative and ephemeral "damage."

As Ameritech stated in its Emergency Motion, it is clear that no other parties would be injured by the FCC's forbearance from enforcement of the rule during the Court's review of these issues. Notwithstanding MCI's claim to the contrary, they Commission has acknowledged that the rule proposes a new methodology for calculation of the annual adjustments; hence, it determined that the rule should have only prospective effect. Thus, the stay leaves intact the reasonable expectations carriers and the public have formed based upon the Commission's existing rules in the price cap context. In short, the requested stay would do nothing more nor less than preserve the status quo for the brief time required to complete judicial review.

Because enforcement of an unlawful rule necessarily contravenes the public interest, the public interest would also be served best by holding the rule in abeyance pending the outcome of the Court's examination.

IV. CONCLUSION

For the foregoing reasons, Ameritech respectfully request the Commission act expeditiously to grant a stay of the *Add-Back Order*.

Respectfully submitted,

THE AMERITECH OPERATING COMPANIES

By: Michael S. Pabian (by ew)

Michael S. Pabian
2000 W. Ameritech Center Drive
Hoffman Estates, IL 60196-1025
(708) 248-6044

Dated: May 15, 1995

Exhibit A

AMERITECH'S ADD BACK IMPACT

Calendar Year 1994

(000,000's)

	Without Add Back	With Add Back	Impact of Add Back
3.3% Productivity			
1994 Sharing Obligation	($20.9)	($44.9)	($24.0)
4.3% Productivity			
1994 Sharing Obligation	$0.0	($8.2)	
Revenue Reduction due to 4.3 Choice in 1993	($10.0)	($10.0)	
Revenue Reduction due to 4.3 Choice in 1994	($5.0)	($5.0)	
Net Revenue Impact	($15.0)	($23.2)	($8.2)

Additional cost to Ameritech, because of Add Back, for not having selected the 4.3% Productivity Choice in 1993 and 1994	($15.8)

Note: Analysis ignores the impact from reduced PCI adjustment required in 1995 annual filing,m 2.8$ to 1.4% that would have been required if 4.3 had been selected in both 1993 and 1994.

CERTIFICATE OF SERVICE

I hereby certify that I have this fifteenth (15th) day of May, 1995, sent copies of the foregoing "Reply of Ameritech to Oppositions to Emergency Motion for Stay" by first class United States mail, postage prepaid, to the following parties to the above-captioned proceeding:

Frank W. Krogh
Donald J. Elardo
MCI Telecommunications Corporation
1801 Pennsylvania avenue, N.W.
Washington, D.C. 20006

Mark C. Rosenblum
Peter H. Jacoby
AT&T Corporation
295 North Maple Avenue
Room 3244J1
Basking Ridge, NJ 07920

Edward Shakin
Edward D. Young, III
Michael D. Lowe
The Bell Atlantic Telephone Companies
1710 H Street, N.W.
Washington, D.C. 20006

Edward R. Wholl
Joseph Di Belia
NYNEX Telephone Companies
120 Bloomingdale Road
White Plains, NY 10605

Robert M. Lynch
Richard C. Hartgrove
Thomas A. Pajda
Southwestern Bell Telephone Company
One Bell Center, Suite 3520
St. Louis, Missouri 63101

Richard McKenna, HQE03J36
GTE Service Corporation
P. O. Box 152092
Irving, TX 75015-2092

Michael J. Shortley, III
Rochester Telephone Corporation
180 South Clinton Avenue
Rochester, New York 14646

M. Robert Sutherland
Bellsouth Telecommunications, Inc.
4300 Southern Bell Center
675 W. Peachtree Street, NE
Atlanta, GA 30375

Jo Ann Goddard
Pacific Telesis
1275 Pennsylvania Avenue, N.W.
Suite 400
Washington, D.C. 20004

James T. Hannon
U.S. West Communications, Inc.
1020 19th Street, N.W.
Suite 700
Washington, D.C. 20036

Gail L. Polivy
GTE
1850 M Street, N.W.
Suite 1200
Washington, D.C. 20036

Mary McDermott
Linda Kent
United States Telephone Association
1401 H Street, N.W.
Suite 600
Washington, D.C. 20005-2136

Rochelle D. Jones
The Southern New England Telephone Company
227 Church Street
New Haven, CT 06506-1806

Michael S. Pabian (by sw)
Michael S. Pabian